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NOT TO BE PUBLISHED IN THE OFFICIAL REPORTS

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION ONE

ALLEN JEROME SHAFRAN et al., Plaintiffs and Appellants, v. FRANCHISE TAX BOARD, Defendant and Respondent.	B186947 (Los Angeles County Super. Ct. No. BC316070)

APPEAL from a judgment of the Superior Court of Los Angeles County. William F. Fahey, Judge. Affirmed.

W. Patrick O'Keefe, Jr. Incorporated and W. Patrick O'Keefe, Jr., for Plaintiffs and Appellants.

Bill Lockyer, Attorney General, W. Dean Freeman, Lead Supervising Deputy Attorney General, and Anthony Sgherzi, Deputy Attorney General, for Defendant and Respondent.

Plaintiffs Allen and Toby Shafran (Shafran) appeal from a judgment in favor of the Franchise Tax Board (FTB) on their complaint for a refund of $118,388 in personal income taxes for the 1992 tax year after the FTB issued a notice of assessment disallowing a depreciation deduction of $503,740. We affirm the judgment, rejecting Shafran's contentions that they were entitled to a jury trial, that the assessment was barred by the statute of limitations, and that the evidence was insufficient to support the judgment denying their claim for a refund.

BACKGROUND

In mid-1990, Shafran formed an "S" corporation, Hybrid Designs, Inc. (HDI), to manufacture components for Litton Guidance & Control Systems (Litton), a military subcontractor. Under its contract with Litton, HDI manufactured electronic components for Litton using specially configured equipment. The agreement called for Litton to purchase from HDI over 31,000 custom circuits for over $13 million.

HDI manufactured the Litton components in a building in Costa Mesa which also housed the operations of three other companies owned by Shafran. HDI performed under the Litton contract until April 10, 1992, when Litton ordered HDI to stop all production, which it did. Later in April 1992, Litton and HDI reached a settlement of their contract pursuant to which Litton paid HDI about $1.4 million. HDI was dissolved in December 1992.

The HDI assembly line was comprised of some newly purchased equipment and some old equipment formerly used by Environmental Communication, Inc. (ECI), another of Shafran's companies which manufactured components for Litton until ECI ran out of money and closed down in 1990. In July 1990, Litton purchased the ECI equipment at auction for about $179,000 and turned over title to HDI, which reimbursed

Litton for the equipment during the course of their contract.[1] In November 1990, Shafran sold some equipment to HDI for $456,128.[2] According to Shafran, at the end of 1990, HDI's equipment was valued at $857,386. According to a document listing HDI's capital equipment expenditures as of December 31, 1991 (exhibit 7), HDI had spent a total of $1,073,971.81 on machinery and equipment. When Litton cancelled HDI's contract in April 1992, Shafran shut down the company and stopped making payments on the building. The lender took over Shafran's building and filed an unlawful detainer action, forcing Shafran to vacate the premises. Sometime around March 1994, HDI's equipment, which had been "collecting dust" after April 1992, was placed in five cargo containers and stored on Shafran's five-acre property in Riverside, where it remained at the time of trial in August 2005.

Shafran claimed a depreciation deduction of $503,740 for the HDI machinery and equipment on their joint 1992 federal and state income tax returns. Their state return for 1992 was filed on October 15, 1993. The Internal Revenue Service (IRS) audited Shafran's 1992 federal return and pursuant to a stipulated agreement with the IRS, Shafran amended their 1992 and 1994 federal returns to eliminate the deduction in 1992 and to claim it in 1994, which resulted in the payment of no additional federal income taxes.

Shafran failed to provide notice to the FTB of the changes to their federal 1992 return. On November 17, 1997, the FTB issued a Notice of Proposed Action, disallowing the $503,740 deduction on Shafran's 1992 return. Shafran filed a protest and exhausted administrative remedies. During the course of the administrative proceedings, Shafran deposited, under protest, $118,388. In May 2004, Shafran filed the instant complaint for

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[1] According to an exhibit admitted at trial, HDI purchased this auction equipment in July 1990 for $169,196, but the exhibit indicated that HDI's records did not reflect any general ledger verification for this purchase.

[2] HDI's records did not reflect any general ledger verification for this purchase.

a refund. FTB answered the complaint and moved to quash Shafran's demand for a jury trial. The court granted FTB's motion to quash in July 2005.

A court trial was held in August 2005. According to the parties' joint statement of facts and issues, Shafran raised two principal contentions: (1) the Notice of Proposed Action issued by the FTB in November 1997 was barred by the four-year statute of limitations and (2) that in 1992 the HDI equipment became obsolete and unusable for the purpose for which it was purchased and Shafran was entitled to the depreciation deduction claimed on the 1992 income tax return.

Allen Shafran testified that all, or almost all, of the items on a list prepared by an auction company (exhibit 14) contained the equipment that HDI had used on its Litton assembly line, which equipment was later stored in cargo containers and moved to Riverside. But exhibit 14 was a document, prepared by an auction company, which listed unsold items of equipment after an auction on behalf of Technology Sales & Service, not HDI.[3] And exhibit 14 contained items such as desks, cabinets, chairs, and beverage vending machines, as well as many items described only as "Blank Item."

Allen Shafran further testified that exhibit 7 contained the list of equipment which was the subject of the depreciation deduction taken on his 1992 state income tax return. The equipment was depreciated by HDI based on a five-year depreciation schedule with an accelerated option for the first year. Shafran claimed on the 1992 tax returns that HDI's equipment, which was purchased for over $1 million, was worth $503,740 at the end of 1992. Exhibit 7, a 22-page document prepared by HDI, captioned "Capital Equipment Expenditures" and dated December 31, 1991, contained a description of various equipment, the date of purchase, the number of the check used for the purchase, the amount of the purchase and whether the purchase was verified in the general ledger of HDI. Exhibit 7 reflected that HDI purchased machinery and equipment from May 1990

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[3] Technology Sales & Service, or T.S.S., was a sole proprietorship owned by Shafran.

to November 1991 for $1,073,971.81. But over one-half of that purchase figure was comprised of two entries (totaling over $625,000) which were not verified by the general ledger of HDI. One entry listed an auction purchase of "Various" property in July 1990 for $169,196.[4] The second entry listed HDI's purchase from Shafran in November 1990 of "Various Capital Equipment per agreement" for $456,128.[5] Exhibit 7 also reflected that as of December 31, 1991, HDI owned automobiles purchased for a total of $59,508.51.

When Allen Shafran was asked what specific equipment was the basis for the $503,740 depreciation deduction, he responded: "I believe I saw some reference to it in my reviewing paperwork, but I would also like to defer to my attorney and accountant. This figure . . . was part of my tax return, and my tax return, the basic material was prepared by some of my accounting staff, who turned it over to my accountant for my personal return." When asked about any discussions with his accountants about the basis for the deduction, he stated, "I have seen memos delineating how that came about, but at the time that the tax return was prepared for my wife and my signature, no." Allen Shafran was asked again what assets were represented by the depreciation deduction and answered, "All of the residual Hybrid Design assets that were on the corporate books." There was no exhibit identified as HDI's corporate books.

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[4] According to Shafran, exhibit 4 contained the list of the auction equipment which was the basis for this entry on exhibit 7. But exhibit 4 included printers, a computer, voltmeters, presses, and 15 file cabinets, and there was no testimony or other evidence establishing that the specific items on exhibit 4 were obsolete or unusable for the purpose for which they were purchased.

[5] According to Shafran, exhibits 5 and 6 contained the list of equipment purchased in November 1990. But exhibit 6 contained one item for $456,128 characterized as "Machinery —ICS Various." Exhibit 5 was a bill of sale and an itemized list of equipment, but the list included microscopes, computers, copiers, work tables, miscellaneous office equipment, and a fax machine. Again, no testimony was offered to explain how or why each specific item on exhibit 5 was obsolete or unusable.

The trial judge asked Allen Shafran how one would know that the $503,740 figure was based on HDI assets and not assets from another of Shafran's companies, and he replied, "My accounting staff came up every year with a list of equipment and the depreciations, and it continues from tax return to tax return to tax return."[6] The judge asked whether Allen Shafran had personal knowledge how the depreciation deduction figure was compiled, and he responded, "Yes, Sir. Those are strictly Hybrid Design assets."

According to Allen Shafran, the equipment listed on exhibit 7 was configured to manufacture hybrid circuits for Litton and when Litton cancelled its contract with HDI, the equipment could not be used for another purpose. But Shafran admitted that he did not examine each item of equipment listed in exhibit 7 and that one of the items, a microscope valued at $3,400, had value independent of the Litton contract. Shafran testified that the equipment was also a "liability" because a large investment would be necessary to scrap the equipment, which contained hazardous materials. He made no attempt to liquidate or sell the equipment; he "decided to walk away from it, leave it. It would be cheaper."

Brian Bentson, the accountant who prepared Shafran's 1992 tax returns, testified that he had no experience in the appraisal of business assets but that he worked closely with HDI's personnel and reviewed HDI's records. He and HDI determined that the equipment was worthless and became obsolete when Litton terminated HDI's contract. According to Bentson, HDI meticulously kept track of its equipment until the cessation of the Litton contract. Bentson also testified that a schedule of assets used to derive the depreciation deduction existed but was not part of exhibit 101, which was identified as Shafran's 1992 federal income tax return. Bentson deferred to HDI's accounting personnel when asked whether the equipment listed in exhibit 7 was the same equipment

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[6] There was no exhibit identified as a previous year's tax return.

which was the basis for the depreciation deduction.[7] But as noted, HDI's corporate books were not in the record. Nor was there any follow-up documentation to exhibit 7 explaining how the $503,740 depreciation deduction was calculated.

In its statement of decision, the trial court determined that the statute of limitations did not bar the FTB's notice of proposed action and that Shafran "failed to carry their

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[7] Bentson's testimony on this point was as follows:

"The Court: How do you know, as you sit here today, that the items listed on exhibit 7 were the same items that you used for the preparation of exhibit 101 [1992 federal income tax return]?"

"The Witness: Okay. Exhibit 7 was the working papers that the accounting personnel of Hybrid Designs, Incorporated, used to manage their fixed asset file. That was submitted to our firm on an annual basis so that we could work with the additions and deletions. As that schedule matured and grew through the years, we also managed the depreciation of those assets. [¶] At the time the 1992 Hybrid Designs income tax return was prepared, we took the net book value of the assets stratified, just the equipment assets, and instead of re-inputting on Mr. Shafran's personal return 22 pages of assets at book value, we lumped it into one line item, because we knew we were going to write it off in full.

"The Court: What exhibit in this package reflects that the more problematic assets listed in exhibit 7, such as microscopes and automobiles, were not incorporated into [the depreciation deduction]?

"The Witness: I believe that the microscopes were part of the assets that were written off.

"The Court: Where does it show that the automobiles were not?"

"The Witness: I believe it's No. 10 . . . .

"The Court: That says the autos were depreciated for half a year. . . .

"The Witness: Then distributed in kind to Allen J. Shafran.

"The Court: So where does it say that the automobiles were not part of this depreciation deduction?

"The Witness: Right here when [HDI's vice president of finance] mentions the distribution in kind. She's addressed it as a physical property distribution and not a write-off of the equipment. That is what she's indicating.

"The Court: And in your opinion, that means, or do you have a personal memory and knowledge that as a result of this memo, you did not include the automobiles? You have a specific memory of that?

"The Witness: I deferred to accounting personnel at the corporate level. They were meticulously working with those, stratification of the assets, to write them off."

burden of proving entitlement to the depreciation deduction taken on their [1992 California income tax return], finding that the testimony of plaintiff [Allen Shafran] was weak and inconsistent especially with respect to his testimony about the acquisition of the majority of the property in the early 1980's as a result of the acquisition [by ECI] of West Corp. [¶] The testimony of accountant Brian Bentson . . . was not credible and neither was his apparent reliance on Exhibit '7', to prove [Shafran's] entitlement to a depreciation deduction for state tax purposes for the 1992 tax year. [¶] The Court finds multiple defects in Exhibit '101' — [Shafran's] individual tax return. By his own admissions [Allen Shafran] testified that he had multiple individual businesses, with multiple assets, and, presumably, multiple depreciable assets, and there was no specificity in Exhibit '101' or in the testimony of the accountant as to why this Court should credit that all of that deduction came from the so-called Litton property which was claimed to be obsolete. [¶] Additionally, even if the Court relied upon [California Code of Regulations, title 18, section 24349(h)], in terms of retirement of the questioned assets, the Court finds that [Shafran] has failed to establish the propriety of taking a depreciation deduction in the amount indicated for that year."

Shafran appealed from the judgment in favor of the FTB.

DISCUSSION

A. Denial of a Jury Trial

Shafran contend that they were entitled to a jury trial on their refund complaint because a claim for a tax refund is a statutory remedy by which the taxpayer is "merely attempting to recover money," so the gist of the action is to collect on a debt, which was triable by jury at common law.

Similar arguments have been rejected by every state that has considered the issue. As summarized by the Supreme Court of Tennessee: "We have not found a single state that authorizes jury trial upon demand in litigation involving the collection or refund of revenue due a state. [¶] Our research reveals that every state that has considered the issue has held that no right to a jury trial exists in litigation involving the collection or refund of state revenue. In *Sonleitner v. Superior Court* [(1958) 158 Cal.App.2d 258

(*Sonleitner*)], the intermediate California appellate court held that there was no constitutional or statutory right to a jury trial in a tax case in California and cited cases from [17 other] states that had reached the same conclusion . . . ." (*Jernigan v. Jackson* (Tenn. 1986) 704 S.W.2d 308, 310.)

Although *Sonleitner* involved an action by the state to collect a motor vehicle fuel license tax, its reasoning is broadly stated and is equally applicable to a refund action brought by a taxpayer. A refund action involves the obligation of the taxpayer for taxes and is thus a type of tax collection proceeding. As explained by the *Sonleitner* court, the state constitutional right to a jury trial extends only to those cases wherein the right to a jury trial existed for an action at law in the context of 1850 common law pleading. (*Sonleitner*, *supra*, 158 Cal.App.2d at pp. 259–260.) But at common law in this country and in England, taxes were not collected by regular judicial proceedings and there was no recognized form of action at common law for the collection of taxes. (*Id.* at p. 262.) And an action to collect taxes is not of the same nature as the common law action of debt; rather, it is "'a sovereign act of the state to be exercised as may be prescribed by the Legislature. . . . Although the tax is an obligation from the citizen to the state, it is not of the same character of obligation as exists between citizens, and for the purposes of its collection the state is not limited to the same mode or to the same procedure which it prescribes for individuals in the collection of obligations between themselves.'" (*Id.* at pp. 261–262.) "A jury trial is thus not a matter of right in an action to collect taxes." (*Id.* at p. 262.)

The trial court did not err in failing to afford Shafran a jury trial.

B. Statute of Limitations

Shafran's contention that the FTB's deficiency notice was barred by the four-year statute of limitations has been rejected by *Ordlock v. Franchise Tax Bd.* (2006) 38 Cal.4th 897 (*Ordlock*). As in *Ordlock*, Shafran failed to report the federal tax liability changes to the FTB, and such failure "dictated the application of [Revenue and Taxation Code] section 19060, subdivision (a), pursuant to which defendant [FTB] was authorized to mail notice of the proposed deficiency assessment *at any time*." (*Ordlock v. Franchise*

Tax Board, supra, 38 Cal.4th at p. 912.) The trial court did not err in rejecting Shafran's statute of limitations argument.

C. Sufficiency of the Evidence

We reject Shafran's argument that the evidence supported the claim for a tax refund, as Shafran seeks to have us apply the wrong standard of review.

On appeal we apply the substantial evidence test to the trial court's factual findings. (*Fujitsu IT Holdings, Inc. v. Franchise Tax Bd.* (2004) 120 Cal.App.4th 459, 470.) Credibility is an issue for the fact finder and we do not reweigh the evidence or reassess the credibility of witnesses. (*Johnson v. Pratt & Whitney Canada, Inc.* (1994) 28 Cal.App.4th 613, 622.)

"In a suit for refund of tax, the burden of proof is on the taxpayer. [Citation.] The taxpayer must not only prove that the tax assessment is incorrect, but also he must produce evidence to establish the proper amount of the tax." (*Honeywell, Inc. v. State Bd. of Equalization* (1982) 128 Cal.App.3d 739, 744.) A taxpayer may recover a refund only if he shows that more has been exacted than in equity and good conscience should have been paid. (*Sprint Communications Co. v. State Bd. of Equalization* (1995) 40 Cal.App.4th 1254, 1259.)

Here, the trial court found that even if the equipment listed on exhibit 7 was obsolete within the meaning of section 24349(i) of title 18 of the California Code of Regulations or was permanently retired from use or abandoned within the meaning of section 24349(h), Shafran was not entitled to prevail because there was insufficient evidence to show that $503,470 was the correct *amount* of any such depreciation deduction.

Substantial evidence supports the trial court's finding. The records submitted by Shafran were insufficiently specific to verify the items which were the basis for the depreciation deduction. As admitted by Shafran and Bentson, at least some items on exhibit 7, like the automobiles and the microscope, should not have been part of the depreciation deduction. And because no document or witness explained the basis of the $503,470 figure or how it was calculated, there was no verification that items such as the

automobiles or the microscope were not part of the depreciation deduction claimed by Shafran.

Apart from the lack of verification of the specific items which formed the basis for the deduction, there was insufficient evidence to establish that $503,470 was the proper *amount* of the depreciation deduction. Although the witnesses testified that previous tax returns, depreciation schedules, memos, working papers, and corporate books existed which showed the calculation of the deduction, those documents were not admitted at the trial. And no witness testified as to the specific methodology and calculations which led to the amount of the claimed depreciation deduction. Thus, substantial evidence supports the trial court's credibility determinations and its conclusion that Shafran had not met the burden "to produce evidence from which a proper tax determination can be made." (*Paine v. State Bd. of Equalization* (1982) 137 Cal.App.3d 438, 442 (*Paine*).)

Without citing pertinent authority, Shafran maintains that because the IRS permitted the depreciation deduction in 1994, when the equipment was removed from the building in Costa Mesa, Shafran needed to establish only that the state tax deduction was properly taken in 1992 rather than in 1994. Shafran thus intimates that the IRS settlement (which permitted Shafran to claim the $503,470 depreciation deduction on their 1994 tax return) either relieves Shafran from the obligation affirmatively to establish entitlement to the depreciation deduction or that the IRS settlement collaterally estops the FTB from challenging the propriety of the depreciation deduction and the amount thereof.

Shafran cites no authority to support the proposition that the IRS settlement relieves them from the obligation affirmatively to establish their entitlement to the refund. (*Paine*, *supra*, 137 Cal.App.3d at p. 442.) Further, the doctrine of collateral estoppel has no application here because the FTB was not a party to the federal proceeding and did not have an opportunity to litigate the issue (*Allen v. McCurry* (1980) 449 U.S. 90, 95 [101 S.Ct. 411, 66 L.Ed.2d 308]; *Rodgers v. Sargent Controls & Aerospace* (2006) 136 Cal.App.4th 82, 90 [party against whom preclusion is sought must be same as, or in privity with, party to former proceeding]), and the IRS settlement cannot afford issue preclusion because there is no evidence that the parties agreed it was

to have such effect (*Arizona v. California* (2000) 530 U.S. 392, 414 [120 S.Ct. 2304, 147 L.Ed.2d 374]).

For all of the foregoing reasons, we reject Shafran's challenges to the sufficiency of the evidence.

DISPOSITION

The judgment is affirmed. Respondent Franchise Tax Board is entitled to costs on appeal.

NOT TO BE PUBLISHED.

MALLANO, J.

We concur:

SPENCER, P. J.

ROTHSCHILD, J.